

No. 77-1324

Supreme Court, U. S.

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**In the Supreme Court of the United States**

OCTOBER TERM, 1977

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ANDERSON, CLAYTON & Co., PETITIONER

v.

UNITED STATES OF AMERICA

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR  
THE FIFTH CIRCUIT

---

BRIEF FOR THE UNITED STATES IN OPPOSITION

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## INDEX

	Page
Opinions below .....	1
Jurisdiction .....	1
Question presented .....	2
Statutes and regulations involved .....	2
Statement .....	2
Argument .....	5
Conclusion .....	14
Appendix .....	1a

## CITATIONS

### Cases:

<i>American Chicle Co. v. United States</i> , 316 U.S. 450 .....	11
<i>Automobile Club v. Commissioner</i> , 353 U.S. 180 .....	7
<i>Brennan v. O'Donnell</i> , 426 F. 2d 218 .....	7
<i>Central Illinois Public Service Co. v. United States</i> , No. 76-1058, decided February 28, 1978 .....	7
<i>Chock Full O'Nuts Corporation v. United States</i> , 453 F. 2d 300 .....	7
<i>Commissioner v. Goodwyn Crockery Co.</i> , 315 F. 2d 110 .....	7
<i>Dixon v. United States</i> , 381 U.S. 68.....	6
<i>Helvering v. Reynolds Co.</i> , 306 U.S. 110..	7
<i>Helvering v. Reynolds</i> , 313 U.S. 428.....	7
<i>Lucas v. Schneider</i> , 47 F. 2d 1006 .....	7
<i>Manhattan Co. v. Commissioner</i> , 297 U.S. 129 .....	7
<i>United States v. California Portland Cement Co.</i> , 413 F. 2d 161 .....	7

## II

Statutes:	Page
Act of September 14, 1960, Section 1a, 74 Stat. 1010 .....	1a
Internal Revenue Code of 1954 (26 U.S.C.):	
Section 861 .....	8, 13
Section 862 .....	13
Sections 901-905 .....	10
Section 901(a) .....	10
Section 902 .....	8, 11
Section 902(a) .....	10
Section 904 .....	2, 10, 1a
Section 904(a) .....	10
Section 904(a) (1) .....	3
Section 904(c) .....	5
Section 905(b) (2) .....	11, 1a-2a
Section 931 .....	8
Section 933 .....	8
Section 951 .....	3, 8
Sections 951-964 .....	3, 9
Section 951(a) .....	9
Section 957 .....	3
Section 963 .....	2, 8, 9
Section 963(a) .....	9, 2a
Section 963(f) .....	10, 3a
Section 7805(b) .....	6, 6a
Retirement Straight-Line Adjustment Act of 1958, Section 103(b), 72 Stat. 1675..	1a
Revenue Act of 1962, Section 12(a), 76 Stat. 1023 .....	2a
Tax Reduction Act of 1975, Section 602 (a), 89 Stat. 58 .....	9
Tax Reform Act of 1976, Pub. L. 94-455, Section 1031, 90 Stat. 1620 .....	5

### III

Miscellaneous:	Page
22 Fed. Reg. 9659 .....	11, 4a
40 Fed. Reg. 45436, Section 1.902-3	
(d) (1) .....	12
H.R. Rep. No. 708, 72d Cong., 1st Sess.	
(1932) .....	11
I.T. 4089, 1952-2 Cum. Bull. 142 .....	11, 13
Owens, <i>The Foreign Tax Credit</i> (1961)....	14
Proposed Treasury Regulations on Income Tax:	
§ 1.902-1(f), 29 Fed Reg. 12836 .....	12
§ 1.902-3(d), 29 Fed. Reg. 12838.....	12, 10a
§ 1.902-5(a), 29 Fed. Reg. 12840.....	12
Rev. Rul. 76-535, 1976-2 Cum. Bull. 219..	7
Rev. Rul. 77-86, 1977-1 Cum. Bull. 241....	7
S. Rep. No. 1881, 87th Cong., 2d Sess.	
(1962) .....	10
T.D. 7378, 1975-2 Cum. Bull. 272 .....	5a, 6a
Treasury Regulations on Income Tax (26 C.F.R.):	
§ 1.901-2(d) .....	13, 3a-4a
§ 1.902-1(c) .....	11, 12, 4a
§ 1.902-1(f) .....	12, 5a
§ 1.902-3(d) .....	12
§ 1.902-3(d) (1) .....	4, 12, 6a
§ 1.902-3(d) (2) .....	12, 6a
§ 1.902-5 .....	5a
§ 1.902-5(a) .....	12, 7a
§ 1.960-1(i) .....	12, 8a
§ 1.963-4(c) (1) .....	10, 10a



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**OPINIONS BELOW**

The opinion of the district court (Pet. App. A, pp. A1-A22) is reported at 387 F. Supp. 601. The opinion of the court of appeals (Pet. App. B, pp. B1-B44) is reported at 562 F. 2d 972.

**JURISDICTION**

The judgment of the court of appeals was entered on November 11, 1977 (Pet. App. C, pp. C1-C2). A petition for rehearing was denied on December 20,

1977 (Pet. App. D, p. D1). The petition for a writ of certiorari was filed on March 20, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

### QUESTION PRESENTED

Whether dividends received by a domestic corporation from its foreign subsidiary should be treated, for the purpose of applying the "per-country" limitation on the foreign tax credit under Section 904 of the Internal Revenue Code of 1954, as having been derived from the country of the subsidiary's incorporation, rather than from the countries constituting the sources of the subsidiary's own earnings.

### STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, as amended (26 U.S.C.) and the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) are set forth in the Appendix, *infra*, pp. 1a-11a.

### STATEMENT

Petitioner is a widely-held domestic corporation engaged, along with a number of foreign subsidiaries, in a variety of business activities, including trading in commodities (Pet. App. A, p. A2; Pet. App. B, p. B3). On its 1964 tax return, petitioner reported the receipt of a "minimum distribution" of earnings and profits (as defined in Section 963 of the Internal Revenue Code of 1954) of \$4,684,233.96 from a Swiss subsidiary, Anderson, Clayton & Co., S.A. ("Laus-

anne"). By reporting this minimum distribution, petitioner avoided the need to include all of Lausanne's income in its own income for that year under the "controlled foreign corporation" provisions of Subpart F of the Code (26 U.S.C. 951 through 964).<sup>1</sup> Although Lausanne had derived most of its earnings during 1964 from the purchase and sale of commodities in Argentina, Brazil and Peru, it paid no tax on this income to those countries, but did pay income tax to Switzerland (Pet. App. A, pp. A3-A5; Pet. App. B, pp. B3-B4).

In computing its foreign tax credit under the "per-country" limitation of Section 904(a)(1) on an amended 1964 return filed in 1968, petitioner treated \$3,233,293 of the minimum distribution from Lausanne as income having its source in Brazil, \$13,659 as income having its source in Argentina, and \$16,842 as income having its source in Peru.

On audit, the Commissioner determined that, for the purpose of computing the "per-country" limitation on foreign tax credits, the distribution from Lausanne instead had its source in Switzerland, the country of Lausanne's incorporation. This determination resulted in a reduction of the petitioner's overall foreign tax credit for the year in question (Pet. App. A, pp. A3-A5; Pet. App. B, p. B4).

After paying the additional taxes assessed, petitioner commenced this refund action in the United

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<sup>1</sup> There is no dispute that Lausanne was a "controlled foreign corporation" within the meaning of Code Section 957 (Pet. 4, n. 4).

States District Court for the Southern District of Texas.<sup>2</sup> The district court upheld petitioner's position because the Commissioner had withdrawn and not reenacted a regulation requiring such minimum distributions to be treated as derived from the country of incorporation (Pet. App. A, p. A10; Pet. App. B, p. B4).

The court of appeals reversed. It noted that designation of the country of incorporation as the source of dividends from a foreign corporation for purposes of the foreign tax credit was far more consistent with the intended interplay between Subpart F. and the foreign tax credit provisions than designation of the countries in which the subsidiary's own earnings were derived. It therefore concluded that the district court should have applied a "country of incorporation" rule, whether or not the Commissioner had promulgated a regulation to that effect (Pet. App. B, pp. B12, n. 15, B22-B23 n. 24). Moreover, the court held (Pet. App. B, pp. B13-B32) that the Treasury Regulation embodying a country of incorporation rule (Section 1.902-3(d)(1) of the Treasury Regulations on Income Tax (1954 Code), adopted in October 1975), was fully applicable to this case. The court ruled that, contrary to petitioner's contention,

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<sup>2</sup> Two other issues were originally involved in this action. One was conceded by the government in the district court (Pet. App. A, p. A2). The district court and court of appeals ruled against petitioner on the other issue (Pet. App. A, pp. A10-A22; Pet. App. B, pp. B32-B44). Petitioner does not seek review of the ruling on this issue (Pet. 6, n. 9).

the Regulation did not represent a change from prior law but rather confirmed the position consistently maintained by the Treasury and approved by Congress (Pet. App. B, pp. B18-B23).

### ARGUMENT

1. Section 904(c) no longer permits a taxpayer, in computing its foreign tax credit, to choose between a "per-country" limitation and an overall limitation. For taxable years beginning after December 31, 1975, a taxpayer must determine its maximum foreign tax credit by reference to the total amount of taxable income from sources outside the United States, without allocation according to individual country. Section 1031, Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1620. Thus, the underlying substantive issue in this case—whether minimum distributions from a foreign subsidiary should be treated as emanating from the country of incorporation or the country in which the income was generated—is of limited continuing importance.

2. Petitioner does not argue that the substantive issue is of administrative importance. It urges (Pet. 2) that the court of appeals reversed the district court "solely on the basis of the presumptive validity and retroactive application of a Treasury Regulation that was not promulgated until after the District Court's decision." This contention is incorrect.

Although the court of appeals held that the Regulation could properly be given retroactive effect, a

decision we believe to be correct (see pp. 9-11, *infra*), it also made plain that it would have reached the same result without the Regulation (Pet. App. B, p. B12 n. 15). The court stated (*ibid.*):

[I]n light of the consistency of the government's rule on sourcing over the years, the constancy of regulations that deem taxes paid by a foreign subsidiary to have been paid in the country of its incorporation, and the facility with which the government's sourcing rule meshes with the legitimate role of the foreign tax credit, the government's sourcing rule appears to us far more consistent with the intended interplay between subpart F and the foreign tax credit provisions. Had the district court considered the relative merit of the two rules, we think it would properly have reached the same conclusion.

Since the court of appeals would have adopted the Commissioner's position even in the absence of the Regulation, there is no occasion to consider in this case whether a court of appeals may deem binding a Treasury Regulation enacted after commencement of the litigation before it. As a general rule, Treasury Regulations are applicable retroactively to cover all years governed by the statute they interpret as long as they do not contravene the statute or well-settled law and the Secretary of the Treasury does not determine, in the exercise of his discretionary authority under Code Section 7805(b), Appendix, *infra*, that they should be applied without retroactive effect. *Dixon v. United States*, 381 U.S. 68, 71-75;

*Automobile Club v. Commissioner*, 353 U.S. 180, 184; *Helvering v. Reynolds*, 313 U.S. 428, 432-433; *Manhattan Co. v. Commissioner*, 297 U.S. 129, 134-135.<sup>3</sup>

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<sup>3</sup> Although the Sixth Circuit in *Commissioner v. Goodwyn Crockery Co.*, 315 F.2d 110, 113 stated, in *dictum*, that Regulations "not in effect at the time the tax liability accrued, or at the time of the [Tax Court] hearing, \* \* \* have no binding force here," there is no conflict between that case and this one requiring resolution by this Court. As the court of appeals here observed (Pet. App. B, p. B17 n. 18: "If it were true that regulations had no binding force merely because they were not in effect when the tax liability at issue accrued, the Secretary would be divested of his discretion to issue retroactive regulations." Yet this Court has held on several occasions that Regulations may be given just such retroactive effect. *Helvering v. Reynolds*, *supra*; *Manhattan Co. v. Commissioner*, *supra*; *Dixon v. United States*, *supra*. Consistent with those decisions, the courts of appeals have concluded that Regulations may be applied retroactively in appropriate cases even when litigation was commenced prior to their adoption (*United States v. California Portland Cement Co.*, 413 F.2d 161, 164 (C.A. 9); *Brennan v. O'Donnell*, 426 F.2d 218 (C.A. 5); *Lucas v. Schneider*, 47 F.2d 1006 (C.A. 6)). It is doubtful therefore that the broad implications of the *Goodwyn Crockery* dictum retain any validity even within the Sixth Circuit.

*Helvering v. Reynolds Co.*, 306 U.S. 110; *Central Illinois Public Service Co. v. United States*, No. 76-1058, decided February 28, 1978, concurring opinions of Brennan and Powell, JJ.; and *Chock Full O'Nuts Corporation v. United States*, 453 F.2d 300 (C.A. 2) (dictum), upon which the petitioner relies (Pet. 8-13), have no relevance to this case. They concern the problem of the retroactive effect of Regulations that propose to change valid Regulations or well settled law.

Rev. Rul. 77-86, 1977-1 Cum. Bull. 241; and Rev. Rul. 76-535, 1976-2 Cum. Bull. 219, upon which petitioner also relies (Pet. 5, 13), do not deal with determining the source of foreign sourced dividends for the purpose of the "per-country"

Here the court of appeals determined that the Treasury Regulation was entirely consistent with the statute and “expresse[d] a position consistently held by the Treasury, though not continuously manifested in the regulations” (Pet. App. B, pp. B18-B19). The court also recognized and relied on the fact (Pet. App. B, pp. B12, n. 15; B20, n. 20; B28-B31) that the rule had received Congressional approval and better effectuated the purposes of the foreign tax credit to avoid double taxation and of the minimum distribution provisions.<sup>4</sup>

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limitation on the foreign tax credit. They involve the sources rules applicable to interest and dividends of a domestic corporation for purposes of Sections 861, 931 and 933 of the Code.

<sup>4</sup> The purpose of the Section 902 credit is best effected by selecting a single country to be deemed the source of both the foreign subsidiary’s dividends and the taxes paid by it on profits from which the dividends are paid. The logical country for this purpose is that which gives the corporation its legal existence and has the ultimate right to tax all of its income. Otherwise, taxes paid to the subsidiary’s country of incorporation with respect to income earned elsewhere might not be allowed as a credit (Pet. App. B, p. B31 n. 32).

Moreover, since the country-of-incorporation rule is applicable to determine the source of a controlled foreign corporation’s income when it is included in a domestic shareholder’s income under Section 951, the application of any other rule under the minimum distribution provisions of Section 963 would allow a taxpayer to minimize the intended tax equalizing effect of that section. Under petitioner’s rule, it would be able to minimize the intended tax equalizing effect of the minimum distribution provision by using such a distribution to claim increased tax credits for the relatively higher tax which petitioner itself paid or was deemed to have paid in Argentina, Brazil, and Peru.

3. The court of appeals correctly determined that, for purposes of computing the foreign tax credit, minimum distributions from a foreign subsidiary should be treated as derived from the country of the subsidiary's incorporation.

a. The selection of an appropriate rule to determine the source of a dividend from a foreign corporation for the purpose of the "per-country" limitation on the foreign tax credit arose in the context of a minimum distribution under Section 963(a), Appendix, *infra*, which is part of Subpart F (Sections 951-964) of the Code.<sup>5</sup> Congress added Subpart F to the Internal Revenue Code of 1954 in 1962 in order to eliminate tax deferral by the use of "tax haven" corporations (such as Lausanne).

Under its provisions, a domestic shareholder of a "controlled foreign corporation" was required to report as income its pro rata share of the subsidiary's undistributed "subpart F income." Section 951(a) of the Code. The domestic shareholder could avoid this result, however, if its foreign subsidiary made a "minimum distribution" of earnings and profits for the year under Section 963(a) of the Code, Appendix, *infra*. Because the purpose of these provisions was to insure that the combined foreign and United States tax on the subsidiary's income would not be substantially below the United States corporate tax

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<sup>5</sup> The "minimum distribution" election under Code Section 963 was repealed by Section 602(a) of the Tax Reduction Act of 1975, 89 Stat. 58.

rate, S. Rep. No. 1881, 87th Cong., 2d Sess., p. 88 (1962), the amount of the required minimum distribution varied inversely with the rate of the foreign income tax paid on the subsidiary's income.

Section 963(f), Appendix, *infra*, directed the Secretary or his delegate to prescribe Regulations to determine, *inter alia*, the amount of the foreign tax credit where a domestic shareholder received a "minimum distribution." Section 1.963-4(c)(1) of the Treasury Regulations, Appendix, *infra*, provided that the foreign tax credit of a United States shareholder with respect to a minimum distribution received for the taxable year would be determined, with exceptions not here pertinent, under the general foreign tax credit provisions of Sections 901 through 905 of the Code.

Sections 901(a) and 902(a) of the Code permit a domestic corporation owning at least ten percent of the voting stock of a foreign corporation from which it receives dividends during the taxable year to claim a credit against United States income taxes for a pro rata proportion of certain foreign taxes paid by the foreign subsidiary on its accumulated profits, as well as for the foreign taxes paid by the domestic corporation. The amount of this credit, however, is subject to the limitations in Section 904.

For the taxable year in issue, Section 904(a) permitted petitioner, in computing its foreign tax credit, to choose between a "per-country" limitation and an "overall" limitation. Under the "per-country" limi-

tation (chosen by petitioner at the time of filing its amended tax return and claim for refund in 1968), the amount of the limitation on the credit for qualifying taxes paid (or deemed paid) to any particular foreign country is essentially the amount of the United States tax attributable to income derived by the taxpayers from sources in that foreign country. Section 905(b)(2) of the Code, Appendix, *infra*, gives the Commissioner broad authority to determine the source of income from foreign countries for the purpose of the "per-country" limitation. See H.R. Rep. No. 708, 72d Cong., 1st Sess., p. 24 (1932).<sup>\*</sup>

b. The Treasury has consistently treated minimum distributions as deriving from the country of incorporation of the foreign subsidiary. As the court of appeals noted (Pet. App. B, p. B19), the Commissioner originally ruled (I.T. 4089, 1952-2 Cum. Bull. 142) that the source of a dividend from a foreign corporation would be the country of that corporation's organization as long as the dividend was not deemed to be from United States sources. In 1957, the Commissioner embodied the rule of I.T. 4089 in Section 1.902-1(c) of the Treasury Regulations, Appendix, *infra*. See 22 Fed. Reg. 9659.

Because of changes made by the Revenue Act of 1962, *supra*, which are not pertinent here, the Commissioner proposed to revise in part the foreign tax

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<sup>\*</sup> Section 902 provides that it is the *dividends* from (and not the profits of) foreign subsidiaries that constitute the income of the domestic corporation. See also *American Chicle Co. v. United States*, 316 U.S. 450, 452.

credit regulations and to limit the regulations (including, among others, Section 1.902-1(c) then in effect to distributions made in years beginning prior to January 1, 1963. At the same time, he also proposed to continue the "country of incorporation" rule for determining the source of dividends for the purpose of the "per-country" limitation on the foreign tax credit since. As the court of appeals pointed out (Pet. App. B, p. B21), the 1962 act made no change warranting a departure from the application of the "country of incorporation" rule for this purpose.<sup>7</sup> See Proposed Treasury Regulations on Income Tax, Sections 1.902-1(f), 1.902-3(d) and 1.902-5(a), 29 Fed. Reg. 12836, 12838, 12840, adopted as Treasury Regulations on Income Tax (1954 Code), Sections 1.902-1(f), 1.902-3(d), and 1.902-5(a), Appendix, *infra*.<sup>8</sup>

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<sup>7</sup> For purposes of the "per-country" limitation on the foreign tax credit, the Commissioner has also applied the "country of incorporation" rule throughout this period to determine (1) the source of the foreign taxes paid by the foreign corporation on the profits from which the distribution was made (Treasury Regulations, Section 1.902-3(d) (2), Appendix, *infra*) and (2) the source of a foreign subsidiary's Subpart F income (Treasury Regulations, Section 1.960-1(i), Appendix, *infra*). Inasmuch as the Commissioner used the "country of incorporation" rule in these situations, it was only logical that he continue to apply the same rule to determine the source of dividends from a foreign corporation for the purposes of the "per-country" limitation on the foreign tax credit.

<sup>8</sup> Sections 1.902-1(f), 1.902-3(d) (2), and 1.902-5(a), Treasury Regulations on Income Tax (1954 Code), Appendix, *infra*, pp. 5a, 6a and 7a were adopted in the same form as originally proposed. Although the adopted text of Section 1.902-3(d) (1),

In October 1975, the Commissioner promulgated Section 1.902-3(d)(1) of the Treasury Regulations (40 Fed. Reg. 45436), which provides that for purpose of the "per-country" limitation on the foreign tax credit a dividend from a foreign corporation is deemed to be derived from sources within the foreign country under the laws of which that corporation is created or organized to the extent that the dividend is not treated as income from sources within the United States.<sup>9</sup> In accordance with the "country of incorporation" rule set forth in this regulation and followed by the Commissioner since it was first introduced in I.T. 4089, 1952-2 Cum. Bull. 142, the court of appeals correctly determined that the minimum distribution received by petitioner was from Swiss sources (Pet. App. B, pp. B3-B32).

Without directly challenging the validity of the rule set forth in this regulation, petitioner nevertheless contends (Pet. 4-5, 12-13) that when it filed its amended 1964 tax return in 1968, Section 1.901-2 (d) of the Treasury Regulations, Appendix, *infra*, required it to determine the source of the minimum distributions received from Lausanne by reference to Sections 861 and 862 of the Internal Revenue Code

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Treasury Regulations on Income Tax (1954 Code), Appendix, *infra*, p. 6a, differs slightly from the original proposed regulation (which was withdrawn and reissued in revised form in July 1974), the differences are not relevant for present purposes.

<sup>9</sup> All of Lausanne's income was derived from sources outside of the United States.

of 1954 (26 U.S.C.) and the regulations promulgated thereunder and that those provisions required it to determine the sources of the minimum distribution in the countries in which Lausanne earned its profit.

This contention is incorrect. Those provisions merely gave the basis for determining whether income is to be deemed from sources within or without the United States. As the court of appeals correctly noted (Pet. App. B, pp. B23-B24 n. 26), "[n]othing in these sections of the Code or in any regulation promulgated thereunder suggests these provisions were intended to provide a general principle to be applied in locating a specific foreign country as the source of dividends income." See Owens, *The Foreign Tax Credit*, p. 227 (1961).

#### CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1978.

## APPENDIX

Internal Revenue Code of 1954, as amended (26 U.S.C.):

## SECTION 904. LIMITATION ON CREDIT.

(a) [as amended by Section 1(a), Act of September 14, 1960, 74 Stat. 1010]. *Alternative Limitations.*—

(1) *Per-county limitation.*—In the case of any taxpayer who does not elect the limitation provided by paragraph (2), the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(2) *Overall limitation.*—In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

\* \* \* \* \*

## SECTION 905. APPLICABLE RULES.

\* \* \* \*

(b) [as amended by Section 103(b), Retirement-Straight Line Adjustment Act of 1958, 72 Stat. 1675]. *Proof of Credits.*—The credits provided in this subpart shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary or his delegate—

\* \* \* \*

(2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this subpart, such amount to be determined under regulations prescribed by the Secretary or his delegate, and

\* \* \* \*

SECTION 963. [as added by Section 12(a), Revenue Act of 1962, 76 Stat. 1006, 1023]. RECEIPT OF MINIMUM DISTRIBUTIONS BY DOMESTIC CORPORATIONS.

(a) *General Rule.*—In the case of a United States shareholder which is a domestic corporation and which consents to all the regulations prescribed by the Secretary or his delegate under this section prior to the last day prescribed by law for filing its return of the tax imposed by this chapter for the taxable year, no amount shall be included in gross income under section 951(a)(1)(A)(i) for the taxable year with respect to the subpart F, income of a controlled foreign corporation, if—

(1) in the case of a controlled foreign corporation described in subsection (c)(1), the United States shareholder received a minimum distribution of the earnings and profits for the

taxable year of such controlled foreign corporation;

(2) in the case of controlled foreign corporations described in subsection (c) (2), the United States shareholder receives a minimum distribution with respect to the consolidated earnings and profits for the taxable year of all such controlled foreign corporations; or

(3) in the case of controlled foreign corporations described in subsection (c) (3), the United States shareholder receives a minimum distribution of the consolidated earnings and profits for the taxable year of all such controlled foreign corporations.

\* \* \* \* \*

(f) *Regulations.*—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the provisions of this section, including regulations for the determination of the amount of foreign tax credit in the case of distributions with respect to the earnings and profits of two or more foreign corporations.

## SECTION 7805. RULES AND REGULATIONS.

\* \* \* \* \*

(b) *Retroactivity of Regulations or Ruling.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

\* \* \* \* \*

Treasury Regulations on Income Tax (1954 Code)  
(26 C.F.R.):

§ 1.901-2 *Definitions.*

\* \* \* \* \*

(d) The principles of part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder shall apply in determining the sources of income for the purposes of subpart A (section 901 and following) of such part III.

\* \* \* \* \*

§ 1.902-1 *Credit for domestic corporate shareholder of a foreign corporation* [22 Fed. Reg. 9659.] (before amendment by Revenue Act of 1962).

\* \* \* \* \*

(c) *Source of income of foreign subsidiaries and country to which tax is deemed to have been paid.* For the purpose of section 904[(a)(1)] [relating to the per-country limitation], dividends of a foreign corporation (at least 10 percent of whose voting stock is owned by a domestic corporation) shall be deemed to have been derived from sources within the foreign country or possession of the United States in which such foreign corporation is incorporated, to the extent that under section 862(a)(2) such dividends are treated as income from sources without the United States. In addition, [for purposes of section 904(a)(1)] all income, war profits, and excess profits taxes paid, or deemed to have been paid under section 902, by such foreign corporation to any foreign country or possession of the United States shall be deemed to have been paid to the country or possession

under whose laws such foreign corporation is incorporated.

\* \* \* \* \*

§ 1.902-1 *Credit for domestic corporate shareholder of a foreign corporation* (before amendment by Revenue Act of 1962).

\* \* \* \* \*

(c) [as amended by T.D. 7378, 1975-2 Cum. Bull. 272]. *Source of income of foreign subsidiaries and country to which tax is deemed to be paid.* For the purpose of section 904(a)(1) (relating to the per-country limitation), a dividend from a foreign corporation (at least 10 percent of whose voting stock is owned by a domestic corporation) shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which such foreign corporation is created or organized, to the extent that under section 861(a)(2)(B) (before amendment by section 9(c), Revenue Act of 1962, 76 Stat. 1001) such dividend is treated as income from sources without the United States. In addition, for purposes of section 904 all income, war profits, and excess profits taxes paid, or deemed to be paid under section 902, by such foreign corporation to any foreign country or possession of the United States shall be deemed to be paid to the foreign country or possession under the laws of which such foreign corporation is created or organized.

\* \* \* \* \*

(f) *Effective dates for the application of this section.* Paragraphs (a) through (e) of this section shall cease to apply as provided in

§ 1.902-5. All references in this section to section 902 are to section 902 before amendment by section 9(a) of the Revenue Act of 1962 (76 Stat. 999).

§ 1.902-3 *Credit for domestic corporate shareholder of a foreign corporation* (after amendment by Revenue Act of 1962).

\* \* \* \* \*

(d) *Source of income from first-tier corporation and country to which tax is deemed paid—*

(1) *Source of income—[Reserved]*

(2) *Country to which taxes deemed paid.* For purposes of section 904, all foreign income taxes paid, or deemed under paragraph (b) of this section to be paid, by a first-tier corporation shall be deemed to be paid to the foreign country or possession of the United States under the laws of which such first-tier corporation is created or organized.

\* \* \* \* \*

§ 1.902-3 *Credit for domestic corporate shareholder of a foreign corporation* (after amendment by Revenue Act of 1962).

\* \* \* \* \*

(d) [as amended by T.D. 7378, 1975-2 Cum. Bull. 272]. *Source of income from first-tier corporation and country to which tax is deemed paid—*(1) *Source of income.* For purposes of section 904(a)(1) (relating to the per-country limitation), in the case of a dividend received by a domestic shareholder from a first-tier corporation there shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which

the first-tier corporation is created or organized the sum of the amounts which under paragraph (a) (3) (ii) of § 1.861-3 are treated, with respect to such dividend, as income from sources without the United States.

\* \* \* \* \*

§ 1.902-5 *Effective dates for the application of section 902* (as amended by Revenue Act of 1962).

(a) *In general.* Sections 1.902-3 and 1.902-4 shall apply, and paragraphs (a) through (e) of § 1.902-1 shall not apply—

(1) To any distribution received from a first-tier corporation by its domestic shareholder after December 31, 1964, irrespective of the date on which begins the taxable year of such first-tier corporation in which are accumulated the profits from which such distribution is made, and

(2) To any distribution received from a first-tier corporation by its domestic shareholder—

(i) Before January 1, 1965.

(ii) In a taxable year of such domestic shareholder beginning after December 31, 1962, but only

(iii) To the extent such distribution—

(a) Is made out of the accumulated profits of such first-tier corporation for a taxable year of such first-tier corporation beginning after December 31, 1962, and

(b) Is not attributable to a distribution received by such first-tier corporation out of the accumulated profits of a second-tier corporation for a taxable year beginning before January 1, 1963.

\* \* \* \* \*

§ 1.960-1 *Foreign tax credit with respect to taxes paid on earnings and profits of controlled foreign corporations.*

\* \* \* \* \*

(i) *Source of income and country to which tax is deemed paid*—(1) *Source of income.* For purposes of section 904—

(i) The amount included in gross income of a domestic corporation under section 951 for the taxable year with respect to a first-tier corporation or a second-tier corporation, plus

(ii) Any section 78 dividend to which such section 951 amount gives rise by reason of taxes deemed paid by such domestic corporation under section 960(a)(1)(C), shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which such first-tier corporation, or the first-tier corporation of such second-tier corporation, is created or organized.

(2) *Country to which taxes deemed paid.* For purposes of section 904, the foreign income taxes paid by the first-tier corporation or the second-tier corporation and deemed to be paid by the domestic corporation under section 960(a)(1) by reason of the inclusion of the amount described in subparagraph (1)(i) of this paragraph in the gross income of such domestic corporation shall be deemed to be paid to the foreign country or possession of the United States under the laws of which such first-tier corporation, or the first-tier corporation of such second-tier corporation, is created or organized.

(3) *Illustrations.* The application of this paragraph may be illustrated by the following example:

*Example.* Domestic corporation N owns all the one class of stock of controlled foreign corporation A, incorporated under the laws of foreign country X, which owns all the one class of stock of controlled foreign corporation B, incorporated under the laws of foreign country Y. All such corporations use the calendar year as the taxable year, and A Corporation is not a less developed country corporation for 1965. For 1965, N Corporation is required under section 951 to include in gross income \$45 attributable to the earnings and profits of B Corporation for such year and \$50 attributable to the earnings and profits of A Corporation for such year. For 1965, because of the inclusion of such amounts in gross income, N Corporation is deemed under section 960(a)(1)(C) and paragraph (c) of this section to have paid \$15 of foreign income taxes paid by B Corporation for such year and \$10 of foreign income taxes paid by A Corporation for such year. For purposes of section 904, the amount (\$95) included in N Corporation's gross income under section 951 attributable to the earnings and profits of Corporations A and B is deemed to be derived from sources within country X, and the section 78 dividend consisting of the foreign income taxes (\$25) deemed paid by N Corporation under section 960(a)(1)(C) with respect to such \$95 is deemed to be derived from sources within country X. The \$25 of foreign income taxes so deemed paid by N Corpora-

tion are deemed to be paid to country X for purposes of section 904.

§ 1.963-4 *Limitations on minimum distribution from a chain or group.*

\* \* \* \* \*

(c) *Special foreign tax credit rules*—(1) *In general.* In determining the minimum overall tax burden under paragraph (a)(1)(ii) of this section, the foreign tax credit of the United States shareholder with respect to a minimum distribution received for the taxable year from the chain or group shall be determined under the provisions of sections 901 through 905 as modified by § 1.963-3 except that—

\* \* \* \* \*

Proposed Treasury Regulations on Income Tax, 29  
Fed. Reg. 12837, 12838

§ 1.902-3 *Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).*

\* \* \* \* \*

(d) *Source of income from first-tier corporation and country to which tax is deemed paid*—  
(1) *Source of income*—(i) *Dividends received.* For purposes of section 904, dividends received by a domestic shareholder from a first-tier corporation shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which the first-tier corporation is created or organized, to the extent that under section 862(a)(2) such dividends are treated as income from sources without the United States.

(ii) *Taxes treated as a section 78 dividend.* For purposes of section 904, the amount of any foreign income taxes which are deemed paid by a domestic shareholder under section 902(a)(1) and paragraph (a)(2) of this section and which are treated under § 1.78-1 as a section 78 dividend received from the first-tier corporation described in section 902(a)(1) shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which such first-tier corporation is created or organized.

(2) *Country to which taxes deemed paid.* For purposes of section 904, all foreign income taxes paid, or deemed under paragraph (b) of this section to be paid, by a first-tier corporation shall be deemed to be paid to the foreign country or possession of the United States under the laws of which such first-tier corporation is created or organized.

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